IN THE

# Supreme Court of the United States

OCTOBER TERM, 1957

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No. 311

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COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

JEAN F. STERN, *Transferee*.

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On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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## BRIEF AMICUS CURIAE ON BEHALF OF THE LIFE INSURANCE ASSOCIATION OF AMERICA

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BENJ. H. SAUNDERS
K. MARTIN WORTHY
*Attorneys for Life Insurance Association of America*
1000 Shoreham Building
Washington 5, D. C.

*Of Counsel:*
ARTHUR PETER
GLENN L. ARCHER, JR.
HAMEL, PARK & SAUNDERS
1000 Shoreham Building
Washington 5, D. C.

since this Court has held and the Government has conceded that there are many types of transactions to which the estate tax applies which are not "transfers" at death which can be reached under the trust fund doctrine.

Congress has repeatedly enacted legislation imposing liability on a life insurance beneficiary in certain cases for the *estate tax* obligations of a decedent, but it has never seen fit to impose such liability for the *income tax* obligations of a decedent. Congress has specifically recognized in other legislation that there is a class of persons (including life insurance beneficiaries) who are liable as transferees for the estate tax obligations of a decedent in addition to those persons who are liable as transferees for the income tax obligations of a decedent.

(2) The cash surrender value of a policy at date of death is not transferred to the beneficiary as a part of the proceeds of the policy. Provisions permitting a policyholder to surrender his policy for a cash value first appeared in level premium policies long after that form of policy was developed. Such values have nothing to do with the death benefit payable to the beneficiary. No fund is maintained by an insurer in connection with a particular policy which corresponds to the non-forfeiture values provided in the policy. A cash surrender option is ordinarily only one of several contract options available to the insured when he ceases to pay premiums. Until that option is exercised there is no definite ascertainable amount owing by the insurer to the insured which can be considered the "property of the" insured. The cash surrender option may be elected only by the insured and the cash value becomes payable only upon surrender of the

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## STATEMENT OF INTEREST

The Life Insurance Association of America is composed of 118 life insurance companies which have written 86 percent of the legal reserve life insurance in force in the United States today. This case involves the issue of the liability of the beneficiary of a life insurance policy for Federal income taxes owed by

the insured which were determined and assessed after the death of the insured.

The interest of the Association in the case arises from such fundamental questions necessarily involved in this issue as the nature of the property interest which an insured has in the insurance contract during his lifetime, the legal status of the reserves and assets of a life insurance company and the relationship of cash surrender values thereto, and the question of what happens to these various rights at the time of death. The disposition of these questions in this case might also have serious implications in other areas, such as whether the statute of wills could or might be applied to life insurance contracts; whether the rights of creditors other than the Government could be enforced against a beneficiary under the circumstances of this case despite well-established principles of law to the contrary, and whether an insurance company is a trustee or custodian of a fund belonging to its policyholders individually. These are questions of fundamental importance to the life insurance companies.

The Life Insurance Association of America submits that a beneficiary has no liability to the Government under the circumstances of this case and its brief therefore supports the position of the respondent. Written consents of both counsel for the respondent and the Solicitor General to the filing of this brief are being filed simultaneously herewith.

## SUMMARY OF ARGUMENT

There is no specific statute imposing liability on a life insurance beneficiary for the income tax obligations of an insured. The Government relies on a liabil-

ity in equity under the "trust fund doctrine" which is said to arise where there has been a "transfer of assets without adequate consideration, either while the transferor is insolvent or resulting in his insolvency and inability to pay his debts." Govt. Brief, p. 10. Consequently, unless there was a transfer of assets from the the insured to the beneficiary there can be no liability. The Government contends that at death the proceeds of the policies—or alternatively, the cash surrender values—were transferred from the insured to the beneficiary. Neither contention is sound.

(1) Under well-settled principles of insurance law, payment of the proceeds of a policy at death does not represent a transfer of property of the insured to the beneficiary. It is incorrect to view payment of the contractual death benefits as the distribution of a fund accumulated during the lifetime of the insured and owned by him up to his death. The insurance company does maintain reserves as required by law to assure solvency. These reserves, however, are the property of the company, not the insured, and no reserve is maintained with respect to a particular policy. The rights of the insured and those of the beneficiary are purely contractual. The taxpayer in the instant case at no time had a right to the death proceeds of the policies. Accordingly, payment of those proceeds by the insurance companies to the beneficiary could in no way involve a transfer of the taxpayer's property to the beneficiary.

Cases upholding the imposition of an estate tax on the proceeds of life insurance paid to a beneficiary do not establish that there is a transfer of property at death within the meaning of the trust fund doctrine,

policy. This contract option terminates upon the insured's death, and neither the option nor the cash surrender value itself is transferred to the beneficiary.

## ARGUMENT

This proceeding was commenced by the issuance of a statutory notice by the Commissioner of Internal Revenue under Section 311 of the Internal Revenue Code of 1939 (now Sec. 6901 Internal Revenue Code of 1954). The Commissioner asserts that respondent, as the designated beneficiary of various insurance policies on the life of her deceased husband, is liable as transferee for certain income tax obligations of her husband determined after his death.

It is well-settled—as acknowledged by the Government in its brief—that the enactment of Section 311 (originally as Section 280 of the Revenue Act of 1926) did not create any new liability; it is *purely procedural* in that it merely authorizes the Commissioner to utilize against a transferee of property of a taxpayer having a "liability, at law or in equity" for the obligations of his transferor the same summary procedures for the collection of income taxes as are available against the taxpayer himself. Govt. Brief, pp. 9 and 35; also see *Phillips-Jones Corp. v. Parmley,* 302 U. S. 233 (1937) and page 43 of the Report of the Conference Committee on the Revenue Act of 1926 (69th Congress, 1st Session, H. R. 356).

There is no specific statute imposing liability on a life insurance beneficiary for the income tax obligations of the person whose life is insured. The Government relies on the so-called trust fund doctrine, which is said to impose a liability in equity where there has been a "transfer of assets without adequate

consideration, either while the transferor is insolvent or resulting in his insolvency and inability to pay his debts." Govt. Brief, pp. 5, 10, 35-36.[1]

There is no evidence that the insured was insolvent at any time prior to his death (Govt. Petition for Certiorari, p. 3; also see R. 18),[2] and respondent was designated as beneficiary of all the policies long before any of the taxable years involved (R. 12, 13). The Government contends, however, that the proceeds of the policies (or, alternatively, the cash surrender values) were transferred to the beneficiary from the insured upon his death, and that since the assets of his estate turned out to be insufficient to satisfy his debts, the beneficiary is liable to the extent of such proceeds (or an amount equal to the cash surrender values) for the income tax obligations of the insured. Govt. Brief, pp. 5-6, 20, 22.

It is the position of the Life Insurance Association of America that in the light of the nature of the insurance contract, and well-established legal principles with respect thereto, the Government is in error

[1] The Government contends that this doctrine applies in the present case despite (a) the provision in section 1652 of Title 28 of the United States Code that "the laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply," and (b) the holding of the court below that under the law of Kentucky there is no liability of a beneficiary to creditors of the insured for obligations existing at his death (R. 19). As the issue of whether the Government must look to state law to establish liability will undoubtedly be argued at length by the parties in their respective briefs, it is not discussed here.

[2] The burden of proof of establishing liability in a proceeding under Section 311 is on the Government. Section 1119(a), Internal Revenue Code of 1939.

in asserting that there is a transfer of either the proceeds or the cash surrender value of a policy from the insured to a designated beneficiary so as to create an equitable liability on the part of the beneficiary to meet the income tax obligations of the insured.

## I. THE PROCEEDS ARE NOT TRANSFERRED FROM THE INSURED TO THE BENEFICIARY

### A. Under General Principles of Insurance Law, Payment of the Death Benefit Involves No Transfer of Property of the Insured.

When a policyholder purchases a life insurance contract, he receives a contract obligation from the insurance company that, if the required premiums are paid, the insurance company will pay a predetermined amount to a designated beneficiary upon the death of the insured. The amount of the premiums required to be paid by each class of policyholders is originally determined according to age, assumed mortality, anticipated expenses, and anticipated return on investments of the insurance company. The obligation of the insurance company, however, is fixed by the contract at the time it is entered into and is in no wise dependent upon the insurer's subsequent actual experience with respect to mortality, expenses or return on investments.

It is incorrect, therefore, to view a life insurance policyholder as the owner of a fund, which is being accumulated by the insurer in connection with his particular policy and is eventually paid as part of the benefits provided. There is no such fund. A brief review of the historical development of the life insurance contract will demonstrate this point.

The earliest form of life insurance was "assessment insurance" under which each policyholder was as-

sessed each year an amount, the same for all ages, sufficient to pay death claims and expenses for the year. The "assessment plan" proved unsatisfactory because the younger policyholders were ~~reluctant~~ tant to pay the high cost of insuring the older ones.

To meet this objection, "yearly renewable term insurance" was devised. Under this plan, each policyholder was required to pay each year an amount (premium) which increased with his age. As in the case of "assessment insurance", the amount so charged was based on what was needed to pay death claims and expenses for the year. But the "yearly renewable term plan" also proved unsatisfactory because the older policyholders eventually found the premiums prohibitive.

To overcome the difficulties of both of these plans, the "level premium plan" was developed. Under this plan, the amount of the premium to be paid each year is determined when the policy is written and remains unchanged thereafter. In the early years of the policy the premium is larger than it would be under a yearly renewable term insurance plan, while in the later years it is much smaller. As in the case of assessment or yearly renewable term insurance, the premiums are used to pay claims and expenses, but the aggregate of the excess premiums in the early years for a large group of policies is a measure of the company's contingent liability for that portion of the future claims which cannot be met from the future premiums alone. Computation of premiums is, of course, based on actuarial averaging. Some persons insured will die prematurely and others will live beyond normal life expectancy. Thus for any given class of persons insured a sufficient amount must be collected from all persons

within the class to meet both current and future liabil
ties. The solvency of the company depends upon th
maintenance of aggregate reserves sufficient to cov
this aggregate future liability.

Reserves on life insurance policies issued under th
level premium plan were maintained by insurers fro
the outset, first by voluntary action of the compani
and later under various state regulatory laws, the firs
of which was enacted in Massachusetts in 1854.[3] Th
laws regulating life insurance reserves were designe
solely to assure solvency of the insurers and did no
deal with, or affect in any way, the contractual obliga
tions of the insurers or the rights of the policyholders

Accordingly, when the insurer pays a death benefi
under a policy, it does not pay a reserve fund main
tained under the particular policy plus an additiona
amount to make up the balance of the benefit payable
it merely satisfies its contract obligations to pay th
amount specified in the policy. *The payment of th
death benefit involves no transfer of the policyholder's
property.* This is so because the policyholder has n
property interest in the reserves or assets of the in-
surer corporation.[4]

These principles have been frequently recognized
and applied by the Federal courts. For example, the
courts have consistently rejected policyholder actions
for an accounting and distribution of the surplus funds
of an insurance company, on the ground that the

[3] See *Reports and Statements on Nonforfeiture Benefits,* published by authority of the National Association of Insurance Commissioners, 1942, p. 19.

[4] Krueger and Waggoner, *The Life Insurance Policy Contract,* 1953, p. 83.

rights of a policyholder are purely contractual and he has no right to any particular assets of the corporation. *Equitable Life Assurance Society* v. *Brown*, 213 U. S. 25, 47 (1909); *Andrews* v. *Equitable Life Assurance Society*, 124 F. 2d 788 (7th Cir., 1941), certiorari denied, 316 U. S. 682.

Mr. Justice Vinson said in *John Hancock Mutual Life Insurance Company* v. *Helvering*, 128 F. 2d 745 (D. C. Cir., 1942), an estate tax collection case:

> "There is much difference between the insurance rights left for X and the willing of a lot to Y. While Y is transferred what decedent had, X receives something much different than decedent ever, or could have had."

In accordance with these principles the Courts of Appeals, in contrast with the Tax Court, have uniformly held that as to the proceeds of a life insurance policy a beneficiary is not "a transferee of property of a taxpayer" for income tax collection purposes within the meaning of Section 311, for the reason that "in no sense were the proceeds ever property of the decedent taxpayer." *Tyson* v. *Commissioner*, 212 F. 2d 16 (6th Cir., 1954); *Rowen* v. *Commissioner*, 215 F. 2d 641 (2d Cir., 1954); *United States* v. *New*, 217 F. 2d 166 (7th Cir., 1954); *United States* v. *Bess*, 243 F. 2d 675 (3rd Cir., 1957), certiorari granted October 28, 1957. See also *United States* v. *Truax*, 223 F. 2d 229 (5th Cir., 1955).[5]

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[5] The designation of a beneficiary in an insurance contract has been held not to violate the Statute of Wills because the right of the beneficiary to enforce is based upon a contractual obligation and not on an interest in the property of the decedent. *Cors* v. *State Mutual Life Assurance Co.*, 196 F. 2d 625 (6th Cir., 1952). Also see *Mutual Benefit Life Insurance Co.* v. *Ellis*, 125 F. 2d 127

The Government seeks to escape the force of this reasoning by contending that, since the policyholder could have changed the beneficiary to his estate, his failure to do so constituted a transfer of the proceeds to the respondent. Govt. Brief, p. 5. This, we think, does violence to the trust fund doctrine and to the language and purpose of Section 311. The purpose of Section 311 was to enable the Government, in a properly applicable case, to invoke the trust fund doctrine to follow "property of a taxpayer" into the hands of a transferee where the taxpayer transferred such property while insolvent, and thereby to prevent prejudice to the Government as a result of the transfer. As this Court long ago pointed out in *Central Bank of Washington* v. *Hume*, 128 U. S. 195, 203-204 (1888), in discussing 13 Eliz. c. 5, which formed the basis of the trust fund doctrine:

> "The object of the statute of Elizabeth was to prevent debtors from dealing with their property in any way to the prejudice of their creditors; but

(2d Cir., 1942), and other cases cited at 94 C. J. S. Wills § 148. In *In re Killien's Estate*, 178 Wash. 335, 35 Pac. 2d 11 (1934), the Supreme Court of Washington, in a very comprehensive opinion reviewing numerous decisions to the same effect in other states, held that in the absence of a specific provision (as in the Federal estate tax statute) imposing a tax on life insurance proceeds, a general inheritance tax statute applying to "all property passing by will or inheritance or by deed, grant, or gift in contemplation of, or intended to take effect at death," did not apply to insurance proceeds payable to a designated beneficiary even though there were contract provisions for the right to change the beneficiary and surrender of the insurance for its cash surrender value, since the right of the beneficiary to receive the proceeds arose under the contract of insurance *rather than by virtue of a transfer at death of property of the insured.* That imposition of the Federal estate tax on insurance proceeds is not based upon the assumption that there is a transfer of property at death from the insured to the beneficiary, see pp. 12-14, *infra*.

dealing with that which creditors, irrespective of such dealing, could not have touched, is within neither the letter nor the spirit of the statute."

In the case at bar, *the taxpayer never had a right to the proceeds of the policies.* Hence the Government never had a right to obtain these proceeds from the taxpayer in payment of his delinquent taxes.[6]

### B. Congress Intended to Make the Beneficiary of Life Insurance Liable for Estate Taxes, But Not for Income Taxes

The Government devotes a major part of its brief to an examination of the *estate tax* statute and the cases decided thereunder in an effort to establish the proposition that where the insured has retained the right until his death to change the beneficiary of his life insurance policy, there is a transfer of the proceeds from the insured to the beneficiary upon the insured's death. Govt. Brief, pp. 13 to 19.

The Government relies in particular on the case of *Chase National Bank* v. *United States,* 278 U. S. 327 (1929), in which the Court upheld the imposition of the estate tax on the proceeds of life insurance poli-

[6] In what appear to be the only cases in the Federal courts not previously referred to, involving attempts by creditors to reach the proceeds of life insurance in the hands of beneficiaries under the principles of the trust fund doctrine, it has been uniformly held that creditors can do so only where it can be shown that the insured has dealt with the policies to the prejudice of his creditors during insolvency prior to death. *Spiro State Bank* v. *Bankers' National Life Ins. Co.,* 69 F. 2d 185 (8th Cir., 1934); *In re Bear,* Fed. Cas. No. 1178 (S. D. Miss., 1875); *Aetna National Bank* v. *Manhattan Life Ins. Co.,* 24 Fed. 769 (S. D. N. Y., 1885); *Aetna National Bank* v. *U. S. Life Ins. Co.,* 24 Fed. 770 (S. D. N. Y. 1885); *Harriman National Bank* v. *Huiet,* 244 Fed. 216 (E. D. S. C., 1916) and *Navassa Guano Co.* v. *Cockfield,* 253 Fed. 883 (4th Cir., 1918). Also see *Pauling* v. *Pauling,* 159 F. 2d 531 (8th Cir., 1947) (based on a state statute identical in principle with the statute of 13 Eliz. c. 5).

cies against the contention that the tax was unconstitutional because it had not been apportioned as is required of a direct tax on property. The Government lays great stress on its contention that imposition of the tax was sustained on the ground that the estate tax is a tax on "transfers." In *New York Trust Company, et al.* v. *Eisner*, 256 U. S. 345 (1921) and *Knowlton* v. *Moore*, 178 U. S. 41 (1900), the Court had said that an estate or legacy tax is imposed on the "power to transmit or the transmission or receipt of property by death", and it is clearly in this sense that the Court upheld the power of Congress to subject life insurance proceeds to the estate tax in the *Chase National Bank* case. There can be no dispute that the beneficiary receives the proceeds on account of the death of the insured, but this is not to say that the proceeds pass out of the insured to the beneficiary at such time. In *Tyler* v. *United States*, 281 U. S. 497 (1930), the Court said that the question for estate tax purposes is not "whether there has been in the strict sense of that word, a 'transfer' of the property by the death of the decedent or a receipt of it by right of succession, but whether the death has brought into being or ripened for the survivor, property rights of such character as to make appropriate the imposition of a tax upon that result (which Congress may call a transfer tax, a death duty, or anything else it sees fit), to be measured in whole or in part by the value of such rights."

The estate tax applies to an *inter vivos* transfer of property in trust where the decedent has reserved the right up to the date of his death to revoke the trust;[7]

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[7] Section 811(d)(1), Internal Revenue Code of 1939. This was sustained in *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339 (1929).

but this Court pointed out in *Jones* v. *Clifton*, 101 U. S. 225 (1880), that it was well-settled that in the absence of insolvency or actual fraud at the time such an interest is created, property cannot be reached by a creditor merely because in creating the interest the debtor retained the power of revocation. The estate tax also applies to property in which the decedent held a joint interest at death;[8] yet the Government stated without equivocation in its Petition for Certiorari in this case that property jointly held by the taxpayer with his wife at the date of death cannot be reached in the hands of his wife under Section 311 for the payment of taxes (Govt. Petition for Certiorari, p. 3).[9] It is thus clear that the estate tax applies to many types of transactions which are not "transfers of property" at death within the meaning of the trust fund doctrine.

It is also clear from the legislative history of the procedures established for collection of the estate tax that it has never been assumed by the Congress that (in the absence of specific statute) the beneficiary of a life insurance policy has any liability to creditors of the insured for debts which cannot be met out of his estate. Congress for the first time, in the Revenue Act of 1918, imposed an estate tax on the proceeds of life insurance made payable to designated benefici-

[8] Section 811(e), Internal Revenue Code of 1939. This was sustained in *Tyler* v. *United States*, 281 U. S. 497 (1930).

[9] See *Irvine* v. *Helvering*, 99 F. 2d 265 (8th Cir., 1938); *Tooley* v. *Commissioner*, 121 F. 2d 350 (9th Cir., 1941); *Parker* v. *Commissioner*, 122 F. 2d 230 (9th Cir., 1941); *Fecarotta* v. *U. S.*, 154 F. Supp. 592 (D. Ariz., 1956). Also see *DeSalvo* v. *Commissioner*, 14 T. C. M. 249, 1955 P-H T. C. Memo Dec., ¶ 55,076, stating that the Commissioner has now abandoned an earlier view to the contrary.

aries under policies taken out by the decedent upon his own life (*Cf.* Section 402(f), Revenue Act of 1918 and Section 202, Revenue Act of 1916). At the same time it provided in Section 409 of the Revenue Act of 1918 that for *estate tax* purposes:

> "If (a) the decedent makes a transfer of, or creates a trust with respect to, any property in contemplation of or intended to take effect in possession or enjoyment at or after his death (except in the case of a bona fide sale for a fair consideration in money or money's worth) or (b) *if insurance passes under a contract executed by the decedent in favor of a specific beneficiary,* and if in either case the tax in respect thereto is not paid when due, then the transferee, trustee or *beneficiary shall be personally liable for such tax,* and such property, to the extent of the decedent's interest therein at the time of such transfer, or to the extent of such beneficiary's interest under such contract of insurance, shall be subject to a like lien equal to the amount of such tax." (Emphasis added)[10]

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[10] The Government contends that the Court below, the Court of Appeals for the Second Circuit in *Rowen* v. *Commissioner,* 215 F. 2d 641 (1954), the Court of Appeals for the Seventh Circuit in *United States* v. *New,* 217 F. 2d 166 (1954), and the Court of Appeals for the Third Circuit in *United States* v. *Bess,* 243 F. 2d 675 (1957), certiorari granted October 28, 1957, are all incorrect in their conclusion that "in no sense were the proceeds ever property of the decedent taxpayer"; it should be noted, however, that in enacting Section 409 of the Revenue Act of 1918 Congress did not consider the words imposing liability on the recipient of property "to the extent of the decedent's interest therein at the time of such transfer" as adequate to cover the proceeds of life insurance, since it found it necessary to add the words "or to the extent of such beneficiary's interest under such contract of insurance." See *John Hancock Mutual Life Insurance Co.* v. *Helvering,* 128 F. 2d 745 (D. C. Cir., 1942).

If the Government were right that a beneficiary of a policy on the life of the decedent (or any person receiving property subject to the estate tax) has always been liable under the trust fund doctrine to the creditors of the decedent, including the Government, for the debts of the decedent's estate, there would have been no necessity for a specific statute imposing such liability on the beneficiary for the estate tax obligations of the decedent's estate. Yet the provision making a beneficiary personally liable for the *estate tax* liability of the insured's estate has been retained in every revenue act since 1918 up through 1954.[11] In fact, although the language has been considerably changed three times since 1918, there is nothing to indicate that Congress ever considered such statute unnecessary.[12]

Even the enactment of a specific statute imposing liability on a life insurance beneficiary for estate tax was not deemed adequate by the Congress to enable the Commissioner to utilize against beneficiaries the summary collection procedures available against

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[11] Section 409, Revenue Act of 1921; Section 315(b), Revenue Acts of 1924, 1926, amended by Section 803(c), Revenue Act of 1932; Section 827(b), Internal Revenue Code of 1939, amended by Section 411(a), Revenue Act of 1942; Section 6324(a)(2), Internal Revenue Code of 1954. As last amended, Section 827(b) of the Internal Revenue Code of 1939 provided that "if the tax herein imposed is not paid when due, then the spouse, transferee, trustee, surviving tenant, person in possession of the property by reason of the exercise, non-exercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under Section 811(b), (c), (d), (e), (f), or (g), to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax. * * *"

[12] Section 315(b), Revenue Act of 1924; Section 803(c), Revenue Act of 1932; Section 411(a), Revenue Act of 1942 and Section 6324(a)(2), Internal Revenue Code of 1954.

transferees. In 1926, Congress inserted in the statute what subsequently became Section 900 of the Internal Revenue Code of 1939 (Section 316 of the Revenue Act of 1926) providing summary collection procedures against transferees for the collection of estate taxes similar to that provided in Section 311 for the collection of income taxes. Both Section 311(f) and Section 900(e) originally defined the term "transferee" to include "heir, legatee, devisee and distributee." Section 900(e) was amended, however, by Section 411(b) of the Revenue Act of 1942 to define the term "transferee" *for estate tax purposes* to include not only an heir, legatee, devisee or distributee, but also to include "a person who, under Section 827(b), is personally liable for any part of the tax." As pointed out by the Court of Appeals in *Rowen* v. *Commissioner*, 215 F. 2d 641 (2d Cir., 1954), Congress did not then, nor has it subsequently, seen fit to add a similar definition to the *income tax transferee* statute.

The Government argues that the words thus added to the *estate tax transferee* statute meant nothing and were merely declaratory of existing law. This is hardly borne out by its legislative history—and the consistent failure of the Congress to make a like change in the income tax transferee statute.

It is significant that in 1954 when Congress completely rewrote the Internal Revenue Code and combined the estate and income tax transferee provisions into a single section (Section 6901 of the Internal Revenue Code of 1954), it continued this distinction in the definition of the term "transferee" for income and estate tax purposes, stating that it includes "donee, heir, legatee, devisee and distributee" for all purposes and that "*with respect to estate taxes, also* includes

any person who under Section 6324(a)(2) [similar to Section 827(b) of the 1939 Code] is personally liable for any part of such taxes" (emphasis added). It would thus appear clear that the distinction made by Congress in these two sections was deliberate.

There is sound basis for this difference in treatment. In the case of the estate tax, the measure of the tax includes the insurance, and it is therefore reasonable that the insurance should be available for payment of the tax. No such reason exists in the case of the income tax.

## II. THE CASH SURRENDER VALUE AT DATE OF DEATH IS NOT TRANSFERRED TO THE BENEFICIARY

The Government contends that even if the respondent is not liable as a transferee to the extent of the entire proceeds of the policies on her husband's life, she is liable as a transferee of the cash surrender value of each of the policies at the date of his death. The theory of the Government is that the cash surrender value itself is "property" of the insured; that the insurance company maintains a "reserve fund" corresponding to this value which is used to pay the death benefit proceeds to the beneficiary; that when the insured dies this cash value "merges" into the proceeds due the beneficiary; and that in this fashion the cash value is "transferred" from the insured to the beneficiary. Govt. Brief, pp. 22-29. This line of reasoning is in all respects inconsistent with the basic concepts of the insurance contract.

It was pointed out in an earlier section that under the level premium plan of insurance, each insured pays a larger premium in the early years than he would under a yearly renewable term insurance plan and that beginning in 1854 various State laws were

enacted requiring the maintenance of reserves by the insurance companies to assure their solvency. The next step in the development of level premium life insurance was the introduction of policy provisions granting rights in the event of nonpayment of premiums. These rights developed gradually and gave recognition to the principle that neither the insurer nor the continuing policyholders should profit as a result of forfeited policies.

In 1861, the first law requiring a nonforfeiture policy provision was enacted in Massachusetts.[13] It provided that in the event of the nonpayment of premiums, an amount determined as provided in the statute should be applied to provide single premium term insurance. Under this and other early statutes, there was no provision that a cash surrender value be provided in the policy. It was not until the turn of the century that standard provision laws began to appear, requiring that policies provide for cash surrender values.[14]

Cash surrender values are precisely what their term implies—an amount available only upon the termination of the policy prior to death and for no other reason and at no other time. *Cash surrender values have nothing to do with the death benefit payable to a beneficiary.* The cash surrender value and the death benefit are separate and independent contractual rights with no part of either being related to or forming a part of the other.

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[13] *Reports and Statements on Nonforfeiture Benefits,* published by authority of the National Association of Insurance Commissioners, 1942, p. 19.

[14] Id., p. 29.

The State insurance laws dealing with nonforfeiture options in effect today require that the option values and option rights be set forth in the policy when issued, which makes it necessary for the company to fix such values in advance.[15] Thus, before issuing a class of policies, an insurer is required to make certain estimates based on assumptions as to future mortality, interest earned on investments and expenses. However, in actual experience mortality, investment earnings and expenses related to a class of policyholders may not conform with the assumptions. Thus the values available upon lapse of a policy are purely contractual. No fund is maintained by the insurer in connection with a particular policy which corresponds to the nonforfeiture values provided in the policy. See *United States v. Penn Mutual Life Insurance Co.*, 130 F. 2d 495 (3rd Cir., 1942).[16]

The policyholder, on lapse of the policy, is ordinarily permitted to elect upon surrender of the policy either (a) the cash surrender value specified therein, or (b) an extended term insurance policy which will require

[15] *Reports and Statements on Nonforfeiture Benefits*, published by authority of the National Association of Insurance Commissioners, 1942, p. 266.

[16] Kentucky law, under which the policies here involved were written, is a good illustration of the separate treatment of the reserves and of the cash value. The first Kentucky reserve valuation statute was enacted in 1870 (Section 29, Chapter 645, Laws of 1870). The first nonforfeiture law was not enacted in that state until 1893 (Section 122, Chapter 171, Laws of 1893). Appropriately, the Kentucky Court of Appeals in the case of *Mutual Benefit Life Ins. Co. v. First National Bank*, 115 Ky. 757, 74 S. W. 1066 (1903), stated, at p. 1070: "Counsel relies upon Section 653, Ky. St. 1899 [the reserve valuation section] as prescribing how policies shall be valued; but this is only for the guidance of the Insurance Commissioner in determining the solvency of the company * * *."

no further payment of premiums but will expire after a given number of years, or (*d*) a paid up insurance policy which will remain in effect until death but in a smaller amount than the original policy. The insurer has no way, of course, of knowing which of these options will be elected in the event of a lapse. "It is only by the voluntary action of the insured or by the terms of the policy, if the insured fails to act, that his rights or privileges under the policy may be accrued and determined. And until that happens, there is no definite liability or amount owing by the insurer to the insured and, hence, *no ascertainable property of the insured* in the possession of the insurer." *United States* v. *Penn Mutual Life Insurance Co., supra.*

The policyholder has no right to the cash surrender value until he exercises his option and surrenders the policy. *United States* v. *Massachusetts Mutual Life Insurance Company*, 127 F. 2d 880 (1st Cir., 1942), and cases cited therein. No debtor-creditor relationship between the insurer and the policyholder arises until these conditions of the policy are met. *United States* v. *Penn Mutual Life Insurance Co.*, and *United States* v. *Massachusetts Mutual Life Insurance Company*, *supra*. Under no circumstances is the insurer in possession of a fund as a trustee answerable to the policyholder. *Equitable Life Assurance Society* v. *Brown*, 213 U. S. 25 (1909).

The Government relies on a number of bankruptcy and other cases, which have nothing to do with the trust fund doctrine or Section 311, in an effort to establish that there is a transfer of the cash surrender value of a policy to the beneficiary at the death of the insured. In *New York Life Insurance Company* v. *Statham*, 93 U. S. 24 (1876), cited at pages 22 and 27

of the Government's brief, certain level-premium policies were forfeited because of the inability of the persons insured to remit premiums to the insurers during the Civil War. After the death of the persons insured, their successors in interest sought to have the policies revived on payment of the back premiums but the insurers refused to pay anything. The Court held that the policies could not be revived, that they had been extinguished by the non-payment of premiums during the war, but that the insurers should refund the excess of premiums paid under the level-premium method up to the dates of forfeiture. There is nothing in the case to suggest that the cash values went over to the beneficiary as a part of the proceeds; on the contrary, the Court merely held that under the unusual circumstances of that case it would be inequitable to permit the insurance companies, having been relieved of their obligations to pay the death benefits, to retain the excess premiums which had been paid by the person insured.

In *Hiscock* v. *Mertens*, 205 U. S. 202 (1907), *Burlingham* v. *Crouse*, 228 U. S. 459 (1913), and *Cohen* v. *Samuels*, 245 U. S. 50 (1917), cited at pages 21 and 23 of the Government's brief, the Court was concerned with the rights of a bankrupt in an insurance policy *during his lifetime*. The bankruptcy statute vested the trustee in bankruptcy "with title to all property of the bankrupt which was not exempt"; it provided that when a bankrupt had an insurance policy which had a cash surrender value he could continue to hold such policy free from the claims of creditors provided he paid over to the trustee an amount equal to the cash surrender value at the time the petition in bankruptcy was filed. In the *Hiscock* case, the question

was whether this redemption provision applied where the policies contained no express provision for cash surrender values but the practice of the insurer was to pay such values, and the Court held that it did. In the *Burlingham* case, the question was whether the bankrupt could retain certain policies in which his estate had been named as beneficiary which had no cash surrender value, and it was held that he could. There is certainly nothing in these cases to suggest that the cash surrender value constitutes a part of the proceeds paid to the designated beneficiary at the policyholder's death.

In the *Cohen* case the question was whether the bankrupt could be required to turn over to the trustee during his lifetime policies in which persons other than the insured's executors or estate had been named as beneficiary, or in the alternative to pay over to the trustee the cash surrender value as of the date of adjudication, and the Court held that he could be so required. There can be no doubt that during the insured's lifetime the right to take down the cash surrender value is a property right and the Court's conclusion in *Cohen v. Samuels* merely recognized the right of an insured's creditors to reach all of his property during his lifetime under the provisions of the bankruptcy statute. But this is a far different matter from holding that the insured's creditors can reach any part of the proceeds of a policy in the hands of a beneficiary after the insured's death.[17]

[17] In *Andrews* v. *Partridge*, 228 U. S. 479 (1913) and *Everett* v. *Judson*, 228 U. S. 474 (1913), the Court held that the right of an executor to retain the proceeds of policies *made payable to the bankrupt's estate*, after the bankrupt's death, was subject to the executor's payment to the trustee of an amount equal to the cash surrender value at date of death. There is nothing in these cases

*In re McKinney*, 15 Fed. 535 (S. D. N. Y., 1883), also cited by the Government, involved an application by an assignee in bankruptcy for court permission to transfer to the bankrupt's widow, after deducting the cash value, a policy on the bankrupt's life payable to his estate. The bankrupt had assigned the policy to the assignee in bankruptcy, the wife had continued to pay the premiums, and the bankrupt had been discharged and later died. The Court granted the application, holding that the assignee in bankruptcy was entitled only to the cash surrender value at the time of bankruptcy, and that the death proceeds were not assets of the insured and should properly go to the widow rather than to the assignee in bankruptcy. The case provides no authority for the Government's contention that the cash values themselves are property of the insured which are transferred to the beneficiary.

The Government also cites *Rowen* v. *Commissioner*, 215 F. 2d 641 (2d Cir., 1954), *United States* v. *Behrens*, 230 F. 2d 504 (2d Cir., 1956), certiorari denied 351 U. S. 919, and *United States* v. *Hoper*, 242 F. 2d 468 (7th Cir., 1957). The *Rowen* case does hold that the cash value is property of the taxpayer which transfers to the beneficiary, although the Court concluded there was no liability under state law. The *Behrens* and *Hoper* cases hold that tax liens which attached to the cash surrender values during the lifetime of the insured could be enforced to the extent of those values

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to suggest that the cash surrender value survives the death of the insured: in the absence of a specific provision in the bankruptcy statute permitting the bankrupt to retain the entire policy upon payment of the cash surrender value to the trustee, it would appear clear that creditors could reach the *entire* proceeds of a policy made payable to the estate, as well as any other assets of the estate in the hands of the executor.

against the proceeds in the hands of the beneficiaries, relying in part on the rationale of the *Rowen* case.[18]

To the extent that these cases hold or suggest that the cash surrender value is property of a taxpayer which is transferred to the beneficiary, we think they are incorrectly reasoned. They fail to distinguish between the cash surrender value itself and the right of the policyholder to elect to receive that value. The policyholder does have a property right in his option under the contract to take the cash surrender value. He does not, however, have a property right in any particular fund or monies of the company. The policyholder's contractual right to elect to take the cash surrender values does not and could not pass to the beneficiary. It may be exercised only by the policyholder. If it is exercised, the policy is cancelled and the right of the beneficiary to the proceeds never comes into being. If it is not exercised, the beneficiary has a right to receive the proceeds from the company upon the death of the policyholder. It is thus apparent that the right of the policyholder to elect to receive the cash surrender value and the right of the beneficiary to the proceeds are mutually exclusive. Consequently it is inconsistent with the provisions of the insurance

[18] Judge Learned Hand stated in the *Behrens* case that "there is no logical escape from holding that the 'surrender value' comes to an end on the insured's death," but that regardless of what he and Judge Medina might therefore have held, "had the question come up as *res nova*," they felt bound by earlier cases to conclude that the lien against the cash surrender value could be enforced against the beneficiary.

In all the other cases cited by the Government for the proposition that a lien attaches to the cash surrender value of a policy (pp. 26, 28, Govt. Brief) the lien was enforced during the lifetime of the taxpayer and no attempt was made to enforce the lien against the death benefits in the hands of the beneficiary.

contract to say that the cash surrender value itself is property of the taxpayer which is transferred to the beneficiary within the meaning of the trust fund doctrine and Section 311.

## CONCLUSION

For the reasons stated, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

Benj. H. Saunders

K. Martin Worthy
*Attorneys for Life Insurance Association of America*
1000 Shoreham Building
Washington 5, D. C.

*Of Counsel:*

Arthur Peter
Glenn L. Archer, Jr.
Hamel, Park & Saunders
1000 Shoreham Building
Washington 5, D. C.